IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

I.T.R. No. 72 of 1995

Date of Decision: 6.11.2007

Commissioner of Income-tax, Patiala

....Applicant

Versus

M/s Gian Chand Labour Contractors Khanauri, Distt. Sangrur

...Respondent.

CORAM:- HON'BLE MR. JUSTICE M.M. KUMAR.

HON'BLE MR. JUSTICE AJAY KUMAR MITTAL.

PRESENT: Mr. Sanjay Bansal, Senior Advocate, Amicus Curiae with
Mr. Yogesh Putney, Advocate and
Mr. Pervesh Saini, Advocate for the revenue.

AJAY KUMAR MITTAL, J.

At the instance of the revenue, the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh (for short "the Tribunal") vide its order dated 10.6.1994 arising out of ITA No.965/Chandi/88 has referred the following question of law under Section 256 (1) of the Income Tax Act, 1961 (for short "the Act") for the assessment year 1987-88 for the opinion of this Court:-

> "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in upholding the adoption of the net profit rate of 8% and then allowing deduction of the amount paid by the

assessee as freight charges to the Truck Operators' Union from the gross receipts?"

Briefly noticed, the facts are that the assessee was a firm of labour contractors doing loading and unloading work of gunny bags from mandi to godowns and from the godowns to Railway Station and vice versa. The assessee received payment of Rs.25,40,127/- from the FCI for the assessment year 1983-84 and made payments on account of freight to the Truck Operators' Union amounting to Rs.11,45,650/- by cheque and Rs.8,66,130/- in cash. The ITO after examining the evidence produced by the assessee rejected the books of account. The Assessing Officer applied the rate of profit at 8% on gross receipts amounting to Rs.25,40,127/- and estimated the total income from contract work at Rs.2,03,000/- as against the declared income of Rs.24,895/-. He also disallowed the expenditures amounting to Rs.5,05,453/- for want of vouchers. Feeling aggrieved by the same, the assessee filed the appeal. The CIT (A) allowed the payments made to the Truck Operators' Union as a deduction but disallowed the other expenditures. The revenue took the matter in appeal before the Tribunal and the Tribunal vide its order dated 10.6.1994 dismissed the appeal holding the net profit rate of 8% on the balance amount of Rs.5,28,347/- to be justified.

No one has appeared on behalf of the assessee to oppose the reference made by the Tribunal. On the asking of the Court, Mr. Sanjay Bansal, Senior Advocate assisted the Court as Amicus Curiae.

The issue that arises for determination in this reference is, as to whether the freight charges paid by the assessee to the Truck

Operators' Union are to be deducted from gross receipts and then net profit rate is to be applied to the gross receipts.

It was submitted on behalf of the revenue that once the net profit rate was applied then in that situation, no occasion is left to deduct any amount from gross receipts as the net profit rate embraces within it all expenses envisaged by an assessee. Our attention was drawn to various provisions of the Act, namely, Sections 29, 144 and 145 for resolving the controversy in its right perspective.

It would be expedient to reproduce the aforementioned sections as they stood at the relevant time which read thus:-

> "29. The income referred to in section 28, shall be computed in accordance with the provisions contained in sections 30 to 43A."
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> "144. If any person-
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> (a) fails to make the return required by any notice given under sub-section (2) of section 139 and has not made a return or a revised return under sub-section (4) or sub-section (5) of that section, or
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> (b) fails to comply with all the terms of a notice issued under sub-section (1) of section 142 or fails to comply with a direction issued under sub-section (2A) of that section, or
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> (c) having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 143,
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> the Income-tax Officer, after taking into account all

relevant material which the Income tax Officer has gathered, shall make the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee or refundable to the assessee on the basis of such assessment."

"145. (1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee.

Provided that in any case where the accounts are correct and complete to the satisfaction of the Income-tax Officer but the method employed is such that, in the opinion of the Income-tax Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine.

(2) Where the Income-tax Officer is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Income-tax Officer may make an assessment in the manner provided in section 144."

After carefully analysing the aforesaid provisions, the legal position that emerges may be summarized thus.

Section 29 of the Act prescribes that the income referred to

in Section 28 which is assessable under the head “profits and gains of business or profession” shall be computed in accordance with the provisions contained in Section 30 to 43 A of the Act. Section 145 of the Act provides for computation of income under Section 29 on the basis of books of account and method of accounting regularly followed by the assessee. However, where the Assessing Officer is not satisfied with the correctness or completeness of said books, he may reject the same and estimate the income to the best of his judgment in accordance with the provisions of Section 144 of the Act. When an estimate is made to the best judgment of an Assessing Officer, he substitutes the income that is to be computed under Section 29 of the Act. Once best judgment assessment is made by fixing a rate of net profit, the assessee's claim for deduction on account of expenses cannot be deemed to have been ignored. The net profit rate is applied after taking into consideration all factors and it accounts for all the deductions which are referred to under Section 29 and are deemed to have been taken into consideration while making such an estimate. .

In view of the aforesaid legal principle, the claim of the assessee cannot be accepted. Additionally, if the contention of the assessee is accepted, the net profit in that situation would be reduced to a substantially low figure and looking to the normal net profit rate which is applicable to the case of civil construction contracts, the effective rate of profit on gross receipts would work out to less than 1% which would be extremely low and not practical. Moreover, once books of account are rejected then no separate deduction on account of

freight charges as claimed by the assessee can be allowed.

The matter came up for consideration before the Andhra Pradesh High Court in **Indwell Constructions v. Commissioner of Income-Tax, [1998] 232 ITR 776** where the Assessing Officer after rejecting the books of account had sought to make certain additions on account of interest and salary paid to the partners in the profit and loss account. It was held that it was not correct in law to make the separate addition representing the interest and remuneration paid to the partners to the income already estimated and assessed from contracts. It was observed as under:-

> "The pattern of assessment under the Income-tax Act, 1961 is given by section 29 which states that the income from profits and gains of business shall be computed in accordance with the provisions contained in sections 30 to 43D of the Act. Section 40 provides for certain disallowances in certain cases notwithstanding that those amounts are allowed generally under other sections. The computation under section 29 is to be made under section 145 on the basis of the books regularly maintained by the assessee. If those books are not correct or complete, the Income-tax Officer may reject those books and estimate the income to the best of his judgment. When such an estimate is made, it is in substitution of the income that is to be computed under section 29. In other words, all the deductions which are referred to

under section 29 are deemed to have been taken into account while making such an estimate. This will also mean that the embargo placed in section 40 is also taken into account.

Where the books of account have been rejected, the Revenue cannot rely on the same books for addition of an exact item (of expenditure) in the profit and loss account."

The Tribunal had relied upon the judgment of Madras High Court in **Commissioner of Income Tax, Madras v. K.S. Guruswami Gounder and K.S.Krishnaraju (Contractors), [1973] 92 ITR 90** on the basis of which, it had decided the issue in favour of the assessee. The issue in the aforesaid case was, whether the cost of material which was supplied to the contractor by the Government for the purpose of construction on their behalf, undertaken by him could be included in the total receipts for the purpose of computing his income. The Madras High Court by placing reliance upon a decision of Kerala High Court in **M.P.Alexander & Co. v. Commissioner of Income-tax, [1973] 92 ITR 92 (Appendix)** noticed that there is no profit-motive in acquiring the materials from the department concerned and the inclusion of the value of the materials in the actual receipts returned by the assessee cannot be included as the assessee cannot be said to have earned any profit in the supply of the said materials by the departments for use in the buildings. It was only on the basis of the actual receipts from the Government that the income was to be calculated. In the present case, the assessee had claimed deduction on account of freight expenses

from gross receipts which is not in the nature of capital cost as was the case before the Madras High Court and the Tribunal was thus, not correct in placing reliance upon the aforesaid decision to decide the issue in favour of the assessee.

During the course of arguments, a reference was made to Section 44AD of the Act which has been inserted by Finance Act, 1994 w.e.f. April 1, 1994. Though the said provision does not have a direct bearing on the controversy involved in the instant case as the present case relates to the assessment year 1983-84, yet, a reference is being made to it as the same was referred by the learned counsel for the revenue. Section 44AD of the Act is a special provision for computation of "profits and gains" of business of civil construction etc. wherein it has been provided that in the cases of all, who are engaged in the business of civil construction or supply of labour for that purpose, a sum equal to 8 per cent of the gross receipts paid on payment to the assessee in the previous year on account of such business shall be deemed to be the profits and gains which shall be chargeable to tax. Further, in sub-section (2) it has been provided that any deduction allowable under the provisions of Sections 30 to 38 shall be deemed to have been given full effect while applying the provisions of sub-section (1) and no further deduction under those sections shall be allowed. It needs special mention that what was implicit earlier has been made explicit by incorporating Section 44 AD by the Parliament w.e.f. 1.4.1994.

A reference was also made to the two Division Bench judgments of this Court in **Commissioner of Income-Tax v. Chopra Bros. India (P) Ltd. [2001] 252 ITR 412** and **Girdhari Lal v.**

Commissioner of Income-Tax and another, [2002] 256 ITR 318 and another judgment of Rajasthan High Court in **Commissioner of Income-Tax v. Jain Construction Co. and others, [2000] 245 ITR 527**. It may be noticed that in the aforesaid cases the issue before the Courts was with regard to deduction to be made on account of depreciation from the gross receipts while applying net profit rate. It was held on the basis of a circular issued by the Board, which was held to be binding on the revenue, that the gross receipts to which net profit rate is to be applied shall be determined after giving allowance on account of depreciation. That is not the position in the present case and these judgments are, thus, distinguishable.

In view of the above, the question of law referred to this Court is answered in favour of the revenue and against the assessee. No costs.

(AJAY KUMAR MITTAL)
JUDGE

November 6, 2007 **(M.M. KUMAR)**
gbs **JUDGE**